# CONGRESSIONAL BUDGET OFFICE
# COST ESTIMATE

April 4, 2006

# H.R. 4973
## Flood Insurance Reform and Modernization Act of 2006

*As ordered reported by the House Committee on Financial Services on March 16, 2006*

## SUMMARY

H.R. 4973 would increase the amount that the Federal Emergency Management Agency (FEMA) can borrow from the U.S. Treasury to cover expenses of the National Flood Insurance Program (NFIP). Under the legislation, FEMA's borrowing authority would increase from $20.8 billion to $25.0 billion. As a result, CBO estimates that enacting H.R. 4973 would increase direct spending by $1.4 billion in 2006 and $2.8 billion in 2007. By raising certain civil penalties, the bill would also increase governmental receipts (revenues) by an estimated $1 million per year.

In addition, the bill would reform the NFIP by requiring FEMA to phase in actuarially sound premium rates for flood insurance on commercial and nonprimary residences (i.e., second and vacation homes). H.R. 4973 also would authorize FEMA to expand the flood insurance program to include new types of insurance and higher dollar limits on the amount of coverage available. The bill would raise the cap on the average annual premium increase allowed for each risk category from 10 percent to 15 percent.

H.R. 4973 would increase the authorization of appropriations for FEMA's flood mitigation and flood mapping programs. Assuming appropriation of the authorized amounts, CBO estimates that resulting outlays would total about $1.1 billion over the 2007-2011 period and an additional $735 million after that period.

H.R. 4973 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments. H.R. 4973 would impose a private-sector mandate on certain mortgage lenders. Based on information from industry and government sources, CBO expects the direct costs to comply with the mandate would fall below the annual threshold for private-sector mandates established in UMRA ($128 million in 2006, adjusted annually for inflation).

## ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 4973 is shown in the following table. The costs of this legislation fall within budget function 450 (community and regional development).

| | By Fiscal Year, in Millions of Dollars | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| **CHANGES IN DIRECT SPENDING [a]** | | | | | | |
| Net Spending Under Current Law for Flood Insurance | | | | | | |
| Estimated Budget Authority | 20,775 | 0 | 0 | 0 | 0 | 0 |
| Estimated Outlays | 20,775 | 0 | 0 | 0 | 0 | 0 |
| Proposed Changes | | | | | | |
| Estimated Budget Authority | 1,425 | 2,800 | 0 | 0 | 0 | 0 |
| Estimated Outlays | 1,425 | 2,800 | 0 | 0 | 0 | 0 |
| Net Spending Under H.R. 4973 for Flood Insurance | | | | | | |
| Estimated Budget Authority | 22,200 | 2,800 | 0 | 0 | 0 | 0 |
| Estimated Outlays | 22,200 | 2,800 | 0 | 0 | 0 | 0 |
| **SPENDING SUBJECT TO APPROPRIATION** | | | | | | |
| Spending Under Current Law for Flood Mitigation and Mapping | | | | | | |
| Budget Authority | 226 | 0 | 0 | 0 | 0 | 0 |
| Estimated Outlays | 223 | 211 | 73 | 30 | 0 | 0 |
| Proposed Changes | | | | | | |
| Authorization Level | 0 | 300 | 300 | 300 | 340 | 340 |
| Estimated Outlays | 0 | 70 | 195 | 255 | 300 | 325 |
| Spending Under H.R. 4973 for Flood Mitigation and Mapping | | | | | | |
| Authorization Level | 226 | 300 | 300 | 300 | 340 | 340 |
| Estimated Outlays | 223 | 281 | 268 | 285 | 300 | 325 |

a. In addition, CBO estimates that revenues would increase by about $1 million a year over the 2007-2016 period.

## BASIS OF ESTIMATE

CBO estimates that enacting H.R. 4973 would increase direct spending by $1.4 billion in 2006 and $2.8 billion in 2007. In addition, assuming appropriation of the authorized amounts, CBO estimates that implementing the bill would add $1.1 billion to discretionary outlays over the 2007-2011 period and an additional $735 million after that period.

### Direct Spending

**Increase in Borrowing Authority**. Through the NFIP, FEMA offers flood insurance in communities that conform to the program's standards for flood plain management. Under current law, if premiums from policy sales and interest income are insufficient to cover the program's costs, FEMA can borrow up to $20.8 billion from the U.S. Treasury. H.R. 4973 would increase the limit on FEMA's borrowing authority to $25.0 billion. Based on information from FEMA about the likely need to pay claims in response to recent hurricanes and the historical rate of claims processing for major floods, CBO expects that the agency would exercise some of that authority in 2006 and the rest in 2007, resulting in additional outlays of $1.4 billion in 2006 and $2.8 billion in 2007.

Current law requires FEMA to repay any borrowed funds (with interest) as it collects premiums, provided that the program's other costs are fully covered. However, CBO expects that the agency would be unlikely to repay funds borrowed under H.R. 4973 within the next 10 years because premium collections over that period will probably be used to pay interest on FEMA's debt and future flood insurance claims and expenses. The agency is likely to face additional claims of $800 million to $1 billion per year for flooding events around the country that typically occur each year. FEMA also will face debt-service costs of about $600 million in 2006 and over $1 billion in 2007 and subsequent years. CBO expects the program will have insufficient funds to pay all of those costs over the next 10 years.

**Pre-FIRM Rate Increase**. H.R. 4973 would authorize the NFIP to gradually increase rates on properties that are either nonresidential structures or not primary residences (such as vacation homes) that were built before the community's flood insurance rate map (FIRM) was completed (or before 1975, whichever is later). Such properties are known as pre-FIRM structures. Under current law and policies, most pre-FIRM structures are charged a flood insurance premium that is less than the full actuarial cost of the insurance. Thus, such policies are considered to be subsidized by the program. The bill would authorize FEMA to increase rates on those specified types of properties by 15 percent a year until the actuarial rate is achieved.

According to FEMA, approximately 450,000 properties meet those criteria, and the average premium for those properties is about $800 a year. CBO expects that owners of some of those properties would either drop flood insurance coverage or reduce their level of coverage in response to an increase in premium charges. In addition, CBO anticipates that the premiums on about 10 percent of the targeted properties would actually decrease as a result of this bill. CBO estimates that reducing the subsidy on these properties would increase receipts from flood insurance premiums by $400 million over the 2007-2011 period and by about $1.5 billion over the 2007-2016 period.

CBO anticipates that any additional receipts generated by increasing insurance premiums on those properties would be spent on paying future flood insurance claims that it would otherwise not have the resources to pay under current law—resulting in no net budgetary impact.

**Increased Coverage Limits and New Lines of Coverage**. H.R. 4973 would increase the total amount of flood insurance that residential customers can buy from $350,000 to $470,000. The bill also would increase the total amount of flood insurance that commercial businesses can buy from $1 million to $1.3 million. In addition, the bill would authorize FEMA to offer four new lines of optional insurance coverage—for living expenses and basement repairs for residential properties, business interruption for commercial properties, and additional contents coverage for residential and commercial property.

The NFIP currently has approximately 4.7 million policies in force, with a total exposure of nearly $800 billion. Those policyholders pay over $2 billion in premiums to the federal government annually. CBO assumes that the increased coverage limits and new lines of coverage would be offered to policyholders when they initiate or renew their coverage. The new coverage would be offered at actuarial rates. These new lines of coverage would increase premium receipts to the federal government, which would be roughly offset by additional claims payments.

**Increase in Annual Limitation on Rate Increases**. H.R. 4973 would authorize the NFIP to increase rates on policies within a specified risk category by an average of 15 percent per year. Under current law, the limit on rate increases is 10 percent. CBO estimates that raising this limit would have no significant impact on the federal budget because FEMA has not increased rates by as much as 10 percent in the past and does not appear to be constrained in its rate-setting process by the current cap on premiums. If additional receipts were generated as a result of this provision, CBO expects that such funds would be spent to pay future flood insurance claims that it would otherwise not have the resources to pay under current law—resulting in no net budgetary impact.

**Civil Penalties**. Section 6 of H.R. 4973 would increase the civil penalty from $350 to $2,000 for lenders that do not enforce the mandatory purchase requirement. CBO estimates that the increased revenue from the civil penalties established under this bill would amount to about $1 million a year.

## Spending Subject to Appropriation

**Mitigation of Severe-Repetitive-Loss Properties.** Section 13 would extend for two years the authorization of appropriations for the mitigation pilot program that funds preventive measures for properties that have sustained four or more losses totaling more than $20,000, or two or more losses that cumulatively exceed the value of the property. Under current law, up to $40 million a year from the National Flood Insurance Fund can be used for this program through 2009. Based on historical outlay rates for mitigation projects, CBO estimates that implementing this section would cost about $45 million over the 2007-2011 period and an additional $35 million after that period.

**Flood Mapping Program**. Section 16 would authorize the appropriation of $300 million a year over the 2007-2012 period for updating flood maps to include the 500-year flood plain and areas that would be flooded if a dam or levee failed. In addition, the bill would reestablish the Technical Mapping Advisory Council to assist with managing flood mapping activities. Based on historical outlay rates for this program, CBO estimates that implementing this section would cost $1.1 billion over the 2007-2011 period and an additional $700 million in subsequent years.

**GAO Study**. Section 3 would authorize the Government Accountability Office (GAO) to conduct a study to assess the status of pre-FIRM properties and the feasibility of extending the mandatory purchase requirement to nonfederally insured mortgages and those properties in the “natural” 100-year flood plain (i.e., those properties behind levees and dams). CBO estimates that this provision would cost less than $500,000 in fiscal year 2007.

**Staff Increases**. Section 19 of the bill would authorize FEMA to hire additional staff to implement the provisions of this bill. Under current law, the NFIP collects about $125 million a year from administrative fees that are collected in conjunction with annual insurance premiums. Subject to appropriation, those fees can be spent on salaries and expenses related to flood insurance operations and flood mitigation. The amount of increased administrative costs that would result from the bill is uncertain because FEMA does not yet know how it would implement various provisions. If staffing increases were significant, however, it is likely that the NFIP would raise the administrative fees assessed on policyholders, and that added income from those fees would offset the increased spending on salaries and expenses.

## ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 4973 contains no intergovernmental mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

## ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 4973 would impose a private-sector mandate, as defined in UMRA, on certain mortgage lenders. Based on information from industry and government sources, CBO expects the direct costs to comply with the mandate would be small—less than the annual threshold for private-sector mandates established in UMRA ($128 million in 2006, adjusted annually for inflation).

Under current law, mortgage lenders that make federally-related mortgages are required to provide a good faith estimate of the amount or range of charges the borrower is likely to incur for specific settlement services. The bill would require such mortgage lenders to include in each estimate a conspicuous statement that flood insurance coverage for residential real estate is generally available under the National Flood Insurance Program, whether or not the real estate is located in an area subject to special flood hazards, and that, to obtain such coverage, a homeowner or purchaser should contact a property insurance agent, broker, or company. The good faith estimate would also be required to contain the statement that the escrowing of flood insurance payments is required for many loans under section 102(d) of the Flood Disaster Protection Act of 1973, and may be a convenient and available option with respect to other loans. According to industry representatives, the cost for mortgage lenders to include additional statements in such an estimate would be minimal.

**ESTIMATE PREPARED BY:**

Federal Costs: Julie Middleton and Perry Beider
Impact on State, Local, and Tribal Governments: Melissa Merrell
Impact on the Private Sector: Paige Paper/Bach

**ESTIMATE APPROVED BY:**

Robert A. Sunshine
Assistant Director for Budget Analysis